ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Florez	Analyst:	Angela Raygoza	Bill Number:	SB 114
Related Bills:	See Legislative History	Telephone:	845-7814	Introduced Date:	January 22, 2007
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Disaster Loss Deduction/Excess Loss Carryover/January 2007 Fresno, Kern, Kings, Madera, Merced, Monterey, San Luis Obispo, Santa Barbara, Tulare & Ventura County For Severe Freezing Conditions

SUMMARY

This bill would allow disaster loss treatment for losses sustained as a result of the January, 2007, freezing conditions in the Counties of Fresno, Kern, Kings, Madera, Merced, Monterey, San Luis Obispo, Santa Barbara, Tulare, and Ventura.

This analysis will not address the bill's changes to the Property Tax Law, as they do not impact the department or state income tax revenue.

PURPOSE OF THE BILL

According to the author’s office, the purpose of the bill is to provide immediate tax relief to individuals and businesses affected by the freezing conditions and related events in Fresno, Kern, Kings, Madera, Merced, Monterey, San Luis Obispo, Santa Barbara, Tulare, and Ventura Counties.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective and operative immediately upon enactment.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Under federal and state law, a disaster loss occurs when property is destroyed as a result of a fire, storm, flood, or other natural event in an area proclaimed to be a disaster by the President of the United States or, for state law purposes, by the Governor.

Board Position:			Department Director	Date
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Under federal and state tax law, the taxpayer may elect to claim the loss either in the year the loss occurs or in the year preceding the loss. This election allows the taxpayer to file an amended return immediately for the prior year. For state purposes, this election may be made for any Presidentially-declared disaster prior to passage of any state legislation allowing special carryover treatment because California conforms to federal law. The election is available for a Governor-only declared disaster only if enabling state legislation is enacted.

A nonbusiness disaster loss not reimbursed by insurance or otherwise is deductible under both state and federal tax law to the extent of two limitations: basis limitation and adjusted gross income (AGI) limitation. Under the basis limitation, a nonbusiness disaster loss is deductible to the extent the loss exceeds $100. Under the AGI limitation, total nonbusiness disaster losses are deductible only to the extent that the total loss amount for the year exceeds 10% of AGI.

State tax law identifies specific events as disasters that are then allowed additional special loss carryover treatment. That is, 100% of the excess disaster loss may be carried over for up to five taxable years, and if any excess loss remains after the five-year period, the remaining loss may be carried over at a specified percentage for up to 10 additional years.

THIS BILL

This bill would add the freezing conditions that occurred in Fresno, Kern, Kings, Madera, Merced, Monterey, San Luis Obispo, Santa Barbara, Tulare, and Ventura Counties, commencing January 11, 2007, to the current list of specified disasters under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL).

This bill would allow this Governor proclaimed state of emergency to be treated in the same manner as Presidentially-declared disasters.

Specifically, this bill would allow special disaster loss carryover treatment of losses sustained as a result of the state of emergency in those counties. The $100 and 10% of AGI limitations in existing law would apply to casualty losses on nonbusiness property.

This bill would also make a non-substantive technical change to the order in which the counties are listed.

IMPLEMENTATION CONSIDERATIONS

This bill lacks a definitive period for about when the freeze disaster occurred. Implementing this bill could result in disputes between the department and taxpayers without further clarifying the language. Department staff is available to assist the author in developing language to resolve this issue.

It is unclear whether revisions to the counties specified in the Governor’s proclamation of a state of emergency that might occur prior to or after enactment of this legislation are intended to be operative for purposes of determining which taxpayers are eligible for the relief provided by this legislation.

LEGISLATIVE HISTORY

AB 62 (Nava) and SB 38 (Battin) of 2007/2008 would allow taxpayers disaster loss treatment for losses sustained in Riverside and Ventura counties as a result of the wildfires that occurred in September, 2006, and October, 2006. These bills are currently in the first house.

AB 164 and AB 2735 (Nava), AB 1798 (Berg), SB 457 (Kehoe) of 2005/2006 would allow taxpayers disaster loss treatment for losses sustained as a result of the Santa Barbara, Ventura, Humboldt, Lake Mendocino, Napa, Sonoma, and Trinity County Severe Rainstorms, Related Flooding, Slides, and other events.

AB 18 (La Malfa, Stats. 2005, Ch. 624) allowed taxpayers disaster loss treatment for losses sustained as a result of the Shasta County wildfires.

AB 1510 (Kehoe, Stats. 2004, Ch. 772) allowed taxpayers disaster loss treatment for losses sustained as a result of the following disasters: the Middle River levee break in San Joaquin County, the Southern California wildfires, floods, mudflows, and debris flows directly related to the Southern California wildfires, and the San Simeon earthquake.

OTHER STATES

Michigan, Minnesota, Massachusetts, and *New York* conform to the federal provisions that allow taxpayers to claim a disaster loss deduction on their state returns either in the preceding year or in the year of the loss. It appears that legislation, executive order, or proclamation by the President or the Governor is required to identify the area impacted by a disaster that is eligible for federal or state assistance.

Florida does not have a personal income tax; however, monetary relief is provided to citizens and corporations through the Emergency Management, Preparedness, and Assistance Trust Fund. *Florida* also requires legislation, executive order, or proclamation to identify the area impacted by a disaster.

PROGRAM BACKGROUND

The freezing conditions in the Counties of Fresno, Kern, Kings, Madera, Merced, Monterey, San Luis Obispo, Santa Barbara, Tulare, and Ventura were proclaimed on January 12, 2007, to be in a state of emergency by Governor Schwarzenegger; President George W. Bush did not declare this freeze to be a federal disaster.

FISCAL IMPACT

This bill would not significantly impact the department’s costs.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the Personal and Corporation Tax revenue loss from this bill would be as follows:

Revenue Analysis for SB 114 – as Introduced January 22, 2007 Enactment Assumed before June 30, 2007 Effective Immediately and Operative January 1, 2006 ($ in Millions)			
Fiscal Year	2006-07	2007-08	2008-09
Disaster Relief	a/	b/	b/

a/ Insignificant Loss of less than $150,000
b/ Insignificant Gain of less than $150,000

This analysis does not consider any possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

According to data from the Department of Food and Agriculture, it is estimated that $1.5 billion in total crop damages occurred to California statewide from the recent freeze. As introduced, this proposal only covers ten of the eighteen counties named at this time by the Governor as being in a state of disaster. Early reports indicate the named counties account for 80% of the statewide damages targeted by this proposal, or roughly $1.2 billion of estimated agricultural losses (80% x $1.5B).

Based on media reports, it is estimated that approximately 85% of the freeze-impacted crops are covered by insurance and would therefore not be affected by this proposal (15% uninsured x $1.2B targeted areas = $180 million uninsured). Under existing law, financial losses from the reduction in value of unharvested crops are not deductible under the casualty loss rules (because crops have zero income tax basis). Hence, the relevant impact of the proposed law would primarily depend on the extent of non-crop losses to farming operations damaged by the specified freeze. For instance, a reduction in the fair market value of a depreciable asset (e.g., tree, irrigation pipe, etc.), supported by an appraisal, would qualify as a disaster loss to the extent of the cost or adjusted basis in the damaged property.

This estimate assumes that 5% of the $180 million in uninsured losses (roughly $9 million) would qualify for disaster treatment. If 20% of uninsured loss were applied to the preceding year, an estimated $140,000 of refunds would be accelerated ($9 million x 20% x 8% tax rate). To the extent such deductions would have been claimed in later years had they not been taken in 2006, there is a minor revenue gain in those later years.—

LEGISLATIVE STAFF CONTACT

Angela Raygoza	Brian Putler
Franchise Tax Board	Franchise Tax Board
(916) 845-7814	(916) 845-6333
angela.raygoza@ftb.ca.gov	brian.putler@ftb.ca.gov